Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

ORIGINAL FILE

In the Matter of	)	
	)	
Petition for Rulemaking to Modify the Regulatory Treatment of COMSAT World Systems' Multi-Year Fixed-Price Carrier-to-Carrier Contract-Based Switched-Voice Services	)	RM No. 7913

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APR - 6 1992

Federal Communications Commission
Office of the Secretary

OPPOSITION OF PAN AMERICAN SATELLITE

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SUMMARY

Comsat is seeking price cap treatment for its switched-voice services, which are the services as to which Comsat has been granted an effective international satellite monopoly. Thus, contrary to Comsat's argument, it faces essentially no competition from separate systems with respect to the services at issue here. As to alleged competition from fiber optic, undersea cable facilities, these facilities do not serve many areas of the globe, and Comsat's argument about vigorous competition is further undermined by such factors as Comsat's long-term contracts with its carrier-users and the common ownership on the foreign end of undersea cable and satellite facilities.

Comsat seeks to compare itself to AT&T and the local exchange carriers ("LECs"), but there are numerous differences. Most importantly, U.S. telephone companies do not have any single cost input that comprises the overwhelming preponderance of their total costs; by far the largest component in Comsat's rates is the Intelsat space segment charge, which Comsat (as the largest owner of Intelsat) has a substantial role in establishing. This problem is compounded by the fact that there is no effective U.S. regulatory check on Intelsat's rates; the FCC has consistently declined to "pierce the veil" separating Comsat's rates from Intelsat's.

The public interest would not be served by adoption of Comsat's proposal. Comsat's promise to cap rates is an empty

one, given the long-term downward trends with respect to space segment charges. Indeed, a rate cap approach may keep prices higher than would otherwise be the case and in addition poses substantial danger of cross-subsidization. The larger margin between costs and prices permitted by the rate cap approach may be used by Comsat to shift profits from the monopoly services in order to underwrite its provision of competitive services.

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OPPOSITION OF PAN AMERICAN SATELLITE

Pan American Satellite ("PAS"), by its attorneys, hereby opposes the Petition for Rulemaking filed by the Communications Satellite Corporation ("Comsat") on January 30, 1992.

PAS operates the first U.S. private international satellite system. Its in-orbit satellite, PAS-1, provides services between and among nations in North and South America, the Caribbean, and Europe. PAS has been conditionally authorized by the Commission to construct, launch, and operate additional satellites in the Atlantic, Pacific, and Indian Ocean Regions. Because of the dominance of Comsat and Intelsat in international satellite communications, PAS has had a longstanding interest in FCC proceedings relating to regulatory oversight of Comsat.

As discussed below, Comsat's Petition is based on a faulty premise: that Comsat is somehow "subject to pervasive competition." Petition at 3. In fact, Comsat faces essentially <u>no</u> competition from separate systems with respect to the switched-voice services that are the subject of the instant Petition. As to fiber optic facilities, the alleged competition to Comsat is not global in scale and is further undercut by Comsat's long-term contracts with its carrier-users and by the common ownership on the foreign end of undersea cable and satellite facilities. Because the technological costs associated with satellites are generally declining, moreover, Comsat's offer to cap its rates is gratuitous; the real issue is whether Comsat will pass through the benefits of lower costs to the users of its monopoly services, or will instead use higher monopoly profits to cross-subsidize its provision of competitive services.

The Commission should not deregulate satellite-based public switched message service, which will remain a Comsat monopoly for the foreseeable future. Rather, the Commission should strengthen the regulatory mechanisms that are required to prevent cross-subsidization between monopoly services and competitive services -- a task that is difficult enough given the FCC's reluctance to pierce the Intelsat veil that Comsat draws around its ratemaking, but one that would be impossible if the Comsat rate cap proposal were adopted.

I. COMSAT'S FACTUAL PREMISE ABOUT COMPETITION IS INACCURATE.

The underpinning of Comsat's Petition is the claim that Comsat "is now the most heavily regulated of all U.S. common carriers subject to the Commission's jurisdiction, even though it exercises much less market power than either AT&T or the LECs, and even though its operations are subject to pervasive competition." Petition at 3. Comsat contends that its competitive situation has changed significantly since 1985, when the

Commission determined to treat Comsat as a dominant carrier. According to Comsat, it faces competition both from fiber optic cables and separate satellite systems and thus "operates in an intensely competitive marketplace." Id. at 13. PAS disagrees.

A. No Separate System Competition.

With respect to separate systems, Comsat is here seeking a form of deregulation in the one area in which it faces effectively no satellite competition whatsoever.[1] Pursuant to U.S. Government policy adopted last year and recently implemented by the Commission, see Letter from Secretary of State Baker and Secretary of Commerce Mosbacher to FCC Chairman Sikes, Nov. 27, 1991; FCC Report No. CC-441 (March 12, 1992), Comsat will continue to have a monopoly on the provision of switched-voice services provided via satellite. It would seem appropriate, therefore, for any deregulation of Comsat's switched-voice services -- to the extent such deregulation is based on separate system competition -- to be tied to complete elimination of the so-called PSN restriction.

B. Illusory Fiber Optic Competition.

Comsat also mistakenly points to alleged competition from fiber optic, undersea cable systems to justify deregulation. While such systems today carry a substantial quantity of switched-voice traffic, there is not effective competition from cable facilities to satellite systems. In fact, despite the

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[1] Separate systems may provide up to 100 64 Kbps-equivalent circuits of switched-voice traffic.

"dramatic" increase in international cable capacity between 1985 and 1992, as noted by Comsat, Petition at 7-12, Comsat's "market share for switched-voice traffic" has declined only marginally, from "approximately sixty percent in the mid-1980s . . . to approach[ing] fifty percent in 1992." Id. at 10.

Undersea fiber optic cables do not provide effective competition to satellites because they exist almost exclusively on high-density routes across the Atlantic and Pacific Oceans. For most of the rest of the world, including particularly most of the developing world, there is no competition for international traffic between satellites and undersea cables. Comsat's argument regarding fiber competition thus applies, at best, to limited geographical areas, with an absence of media diversity -- and hence of satellite-cable competition -- in much of the rest of the world.

It is also the case that, in international communications, intermedia competition is limited by common ownership factors. The foreign ends of most international cables are controlled by the same entities that hold ownership interests in Intelsat. Because these foreign entities have embedded investments in the Intelsat system and an interest in preserving the financial strength of Intelsat, the decision between international cable and satellite facilities is not made on the basis of market forces, but rather is a corporate decision regarding allocation of traffic.

Finally, Comsat's competition from cables is limited by the "long-term fixed-price contracts," Petition at 5, that Comsat put in place as a substitute for the FCC's "balanced loading" requirements. See id. at 3. As Comsat concedes, these contracts not only guarantee it a substantial quantity of AT&T's and MCI's current traffic, but also an opportunity to grow along with these carriers' "growth traffic" over time. Id. at 10. Thus, contrary to Comsat's assertion, its major customers cannot "simply . . . shift . . . an ever-increasing portion of traffic to [fiber optic[facilities." Id. at 18.

II. COMSAT'S ATTEMPT TO COMPARE ITSELF TO AT&T AND THE LECs SHOULD BE IGNORED BY THE COMMISSION.

A. Comsat and AT&T.

Comsat's Petition repeatedly analogizes its situation to that of AT&T and the LECs, claiming that they are subject to reduced regulation and that they somehow exercise more "market power" than does Comsat. Petition at 2-3. Comsat argues that its relatively modest market share decline from 1985 to 1992 gives Comsat today "about the same portion of the relevant market that AT&T has for its business services." Id. Comsat goes on to characterize the Commission as having "found with respect to AT&T that a market share of 'about 50 percent . . . is not incompatible with a highly competitive market.'" Id. at 11, quoting Competition in the Interstate Interexchange Marketplace, 6 F.C.C. Rcd. 5880, 5890 (1991).

The Commission made no such "finding." It did not accept the premise that "market share is relevant to an assessment of . . . competition"; indeed, it stated that "market share alone is not necessarily a reliable measure of competition, particularly in markets with high supply and demand elasticities." 6 F.C.C. Rcd. at 5890. The Commission further found "that business customers are to a large degree demand-elastic and will switch carriers in order to obtain price savings and desired features," and that there was "apparent excess supply capacity of existing competitors in the marketplace." Id. at 5887-88.

Comsat has made no similar claims here. Most users of Comsat's switched-voice services do not have the option to "switch carriers in order to obtain price savings and desired features." As Comsat itself points out, its switched-voice customers are large carriers that are locked into "long-term arrangments" with Comsat. Petition at 4. Thus, whereas the Commission found that AT&T could relatively quickly lose substantial market share in the business services sector to its competitors, Comsat is guaranteed a significant market presence for years to come. There is also no evidence of "excess supply" in the international switched-voice market; indeed, Intelsat has repeatedly projected a tight capacity situation in the 1990s. For these reasons, it is fallacious to compare, as Comsat does repeatedly, AT&T's domestic market share for business services with Comsat's share of the international switched-voice traffic market.

B. Comsat and the LECs.

As for the LECs, the Commission's regulatory approach to them is informed by the fact that these carriers are also subject to pervasive regulation at the state level. Comsat, of course, is not regulated by any state public service commissions. In addition, the largest of the LECs, the Bell Operating Companies ("BOCs"), are subject to competitive constraints imposed by the antitrust laws, including the quite specific restrictions of the modified final judgment ("MFJ"). Comsat, of course, is not subject to the MFJ, and its actions as Intelsat Signatory are immunized from antitrust review, thereby allowing it to manipulate with impunity Intelsat's ratemaking and other responses to competition. See Alpha Lyracom Space Communications, Inc. v. Communications Satellite Corp., 946 F.2d 168 (2d. Cir. 1991), cert. denied, 112 S. Ct. ____ (1992).

C. Comsat's Influence Over Intelsat's Rates.

This last factor, the role of Comsat in Intelsat's decision-making processes, is perhaps the most important distinction between Comsat and the U.S. telephone companies. These latter companies do not have any single cost input that comprises the overwhelming preponderance of their total costs; by far the largest factor in Comsat's rates is the cost of Intelsat space segment. The telephone companies, moreover, generally purchase goods and services from unaffiliated third parties; by contrast, Comsat owns about one-fourth of the company, Intelsat, from which Comsat obtains space segment. By virtue of Comsat's significant ownership stake in Intelsat and the weighted voting used on Intelsat's Board of Governors (which gives Comsat approximately twice the voting power of Intelsat's next largest owner), Comsat has substantial influence with respect to Intelsat's procurement decisions and its approach to ratemaking issues.

Comsat's influence over Intelsat's rates has not generally been acknowledged by the FCC, which has consistently refused to "pierce the veil" between Comsat's rates and Intelsat's. Whereas the telephone companies may at any time have their cost factors examined by the Commission and/or state public utility commissions, there is no effective U.S. regulatory check on the single most important component of Comsat's costs, the rates charged by Intelsat.

Taken together, the lack of effective regulatory oversight of the Intelsat rate component and Comsat's substantial influence over Intelsat's rates present an obvious potential for self-dealing and provide grounds for rejecting Comsat's deregulation proposal.

III. COMSAT'S RATES WILL STABILIZE OR DECLINE WITHOUT A RATE CAP.

Comsat's principal public interest argument for the rate cap approach is that its customers would benefit, because Comsat would not be able to increase its rates. Comsat offers to impose "an absolute ceiling at prices in effect as of January 1, 1992," and claims that there will be "additional downward pressure on Comsat's rates." Given the competitive situation claimed by Comsat, however, its promise to cap rates must be viewed as empty.

A. Comsat's Rates Have Been Declining.

Comsat's "long-term fixed-price contracts" with its major customers, Petition at 5, prevent it from raising rates, and indeed the trend is in the opposite direction. Without any rate cap, Comsat's and Intelsat's nominal and real rates have declined markedly over the past 25 years, and there is no reason to believe that this trend will be reversed at any time in the near future. Thus, under any regulatory scenario, Comsat's rates are not going to increase in the foreseeable future.

In fact, there is a danger that the rate cap approach will keep prices higher than would otherwise be the case. If Comsat's real costs are decreasing, as they have been in recent years, then the rate cap approach simply allows Comsat to earn returns well in excess of its costs, and, as discussed below, use those excesses to subsidize the rate for competitive services. A preferable approach from the standpoint of Comsat's users would be to require that, as Comsat's costs decrease, its rates must decrease as well.

B. Cross-Subsidization.

The partial rate cap proposed by Comsat contains within it the possibility that cross-subsidization will occur between Comsat's monopoly and competitive services. Because Comsat is proposing a rate cap solely with respect to a monopoly service, it would be able to use revenues from the potentially large margins between its costs and the rate ceiling in order to underwrite the below-cost provision of competitive services.

Comsat's response to this possibility is to claim that it "could not occur," on the theory that competitive services "will remain subject to traditional regulation," and that "users will be safeguarded from cost shifting by the accounting system and costs allocation procedures which the Commission has crafted for Comsat." Petition at 19. In fact, in another proceeding, Comsat is seeking changes in the current "accounting system and cost allocation procedures." See Comsat Petition for Declaratory Ruling, File No. ISP-92-001 (mobile and maritime services).

More importantly, the Commission's regulation of Comsat's rates for competitive services has been quite minimal. With one exception,[2] PAS is not aware of any instance in recent years in which the Commission has intervened even to question, much less to modify, Comsat's rates for demonstrably competitive services. As discussed above, moreover, the FCC has generally been reluctant to pierce the veil separating Comsat's rates for its services from the largest component of those rates, Intelsat's space segment charges. It is, therefore, not reasonable to expect that, once Comsat's monopoly service is subject to a price cap, any cross-subsidization abuses will be taken care of in the Commission's regulation of rates for competitive services.

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[2] Communications Satellite Corp., Mimeo No. 2809 (Common Carrier Bureau, April 16, 1987). This proceeding involved a proposed Comsat/Intelsat service called "Caribnet," which the Bureau found involved "discounted pricing" that might be "predatory." ¶ 17. Comsat withdrew this service proposal after issuance of the Bureau's order.

IV. THE COMMISSION SHOULD CONSIDER ALTERNATIVES FOR REGULATION OF COMSAT.

Although PAS opposes the approach proposed by Comsat in the Petition, PAS is not unsympathetic with Comsat's underlying suggestion that the FCC use its regulatory tools to promote competition and efficiency in telecommunications. Given the changes in international communications, the time is ripe for the Commission to take a fresh look at its regulation of Comsat. Such a review, however, should come, not in response to narrow requests made by Comsat, see, e.g., File No. ISP-92-001 (Comsat declaratory ruling request); File No. ISP-92-004 (Comsat waiver request); RM No. 7931 (Comsat rulemaking request), but in a broad proceeding similar to the earlier "Comsat Study" proceedings, which took a comprehensive look at Comsat regulation, with substantial public input.[3]

Such a broad framework would allow the FCC to focus not only on the dominant carrier and ratemaking issues raised by Comsat, but also on the questions of how Comsat's "jurisdictional" services are separated from its "nonjurisdictional" services. When the distinction between these two categories of services was established years ago, there was no competition in the "jurisdictional" category. Today, as Comsat points out, many of

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[3] See Communications Satellite Corporation, 77 F.C.C.2d 564 (1980) ("Comsat Study"); Changes in the Corporate Structure and Operations of Comsat, 90 F.C.C.2d 1159, 1199 (1982) ("First Comsat Structure Order"), on reconsideration, 93 F.C.C.2d 701 (1983); Changes in the Corporate Structure and Operations of Comsat (Second Memorandum Opinion and Order), 97 F.C.C.2d 145, 179 (1984) ("Second Comsat Structure Order"), on reconsideration, 99 F.C.C. 2d 1040 (1984) ("Second Reconsideration Order").

its services (with the specific exception of the services for which Comsat now wants price cap regulation) are subject to competition.

Assuming that the Commission were to adopt a structural separation approach that more effectively recognizes the distinction between Comsat's competitive and monopoly services, then Comsat's price cap proposal may make sense for those services subject to true competition. It is the competitive services, not the monopoly services, as to which rates are held in check by market forces and are unlikely to be the focus of detailed ratemaking scrutiny by the Commission, as discussed above.

V. CONCLUSION.

For the foregoing reasons, PAS opposes the Comsat Petition. The Petition is based on erroneous factual premises and does not promise that users will benefit from cost decreases in the future. The Commission should accordingly deny Comsat's

Petition, while considering in a broader proceeding the larger issues relating to Comsat's structural separation and its provision of competitive and monopoly services.

Respectfully submitted,

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April 6, 1992

<u>CERTIFICATE OF SERVICE</u>

I hereby certify that a copy of the foregoing Opposition of Pan American Satellite was served by United States first class mail, postage prepaid, this 6th day of April, 1992, on the following:

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